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CITY MANAGER

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TO: The Honorable City Council

FROM: L. Kimball Payne, III, City Manager 

SUBJECT: *Proposed FY 2007 Budget*

DATE: March 7, 2006

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## **Introduction**

The *Proposed FY 2007 Budget* for the City of Lynchburg includes the General, Schools, Capital, Airport, Water, Sewer, and Solid Waste Management Funds, as well as other minor funds and totals \$259 million. The proposed budget reflects a mixed revenues picture with some slight increases in major revenue categories and decreases in others. Of major impact on the expenditure side is the escalating costs of providing adequate employee compensation and a reasonable benefits package. In order to counter this expense the proposed budget will reduce the size of City staff. Increasing energy costs also have a negative impact on the budget. One significant positive event is the expectation of significant additional State funding for the City Schools. This is tempered by the recommendation that local funding for City Schools be reduced in order to address costs in other areas. In general, the *Proposed FY 2007 Budget* reflects the continuing fiscal challenges facing the City of Lynchburg.

## **Budget Development**

In the abstract, budget development is guided by two principal sets of guidelines, the Financial Management Policies and priorities adopted by City Council.

### *Financial Management Policies*

City Council first adopted Financial Management Policies in 1999 and has amended and reaffirmed them as appropriate. The policies address such areas as adopting a balanced budget, the appropriate fund balance to maintain, restrictions on its use for recurring operating expenses, debt management and the establishment of contingency reserves to address unexpected circumstances. If followed, sound financial management policies should do the following:

- Contribute significantly to the City's ability to insulate itself from fiscal crisis and economic disruption
- Enhance short-term and long-term financial credit ability by helping to achieve the highest credit and bond ratings possible
- Promote long-term financial stability by establishing clear and consistent guidelines
- Direct attention to the total financial picture of the City rather than single issue areas
- Promote the view of linking long-term financial planning with day to day operations



- Provide City Council and the citizens a framework for measuring the fiscal impact of government services against established fiscal parameters and guidelines
- Ensure that the organization is sufficiently resourced to perform mandated responsibilities
- Provide a foundation for evaluating financial analysis and condition

The Financial Management Policies are included in the General Budget Information section of the budget document. The proposed budget complies with adopted Financial Management Policies.

### *City Council's Priorities*

City Council has identified and annually reviews priorities upon which City staff should focus resources. The priorities establish a baseline for City policy development and operations. Priorities identified by City Council include:

- A superior education community
- Stable, productive inspired families
- A dynamic economic development center with emphasis on downtown and increased real estate value
- A community environment second to none with emphasis on public safety and infrastructure
- Responsive, effective local government with emphasis on boards and commissions, fiscal responsibility, excellent core services, and fighting unfunded mandates

In addition to Council's priorities, there are a number of operating principles important to the sound management of an organization that must meet mandated and contractual financial commitments while delivering quality services to the citizens of Lynchburg. Those principles include:

- Fund debt service
- Fund mandated programs
- Maintain a fund balance in accordance with fiscal policy
- Fund school construction at a level previously committed to by City Council
- Provide appropriate compensation for City employees
- Preserve employee benefits
- Replace essential equipment, especially vehicles and computers
- Maintain existing facilities
- Provide excellent core services
- Provide quality customer service

For FY 2007 significant resources need to be devoted to debt service, employee compensation, benefits, and fuel.

### *Budget Preparation*

City departments and City Schools started preparing for the FY 2007 Budget in the Fall of 2005. That process consisted of an analysis of current revenues and expenditures compared to the adopted FY 2006 Budget, the gathering of information on significant events that might affect either costs or revenues, monitoring budgets proposed by the Federal and State governments, and considering the resources



required to address identified priorities. As all of the data was compiled, it became apparent that a number of things would have an impact on the budget.

The most significant issues identified during budget preparation included:

- \$1.0 million cost for the 3% (average) pay increase for City employees effective January 1, 2006
- \$726,000 increase in Virginia Retirement System (VRS) costs; as of July 1, 2006 the City will be paying 20.26% of salaries for employee retirement benefits
- \$481,000 due to the expiration of the VRS life insurance premium holiday; this benefit costs 1.22% of payroll
- \$860,000 increase in health and dental coverage for City employees and retirees, a 15% increase
- \$315,000 reduction in transfers from the enterprise funds due to a recalculation of the indirect cost allocation formula
- \$344,000 loss of Federal Revenue Maximization funding for Social Services programs
- \$408,000 loss in Public Service Corporation Real Property Tax revenue
- \$1.5 million to provide an average compensation increase of 3% to City employees on July 1, 2006
- \$629,000 for requested new positions and related personnel costs
- \$576,000 for vehicle fleet replacements
- \$1.6 million in additional debt service (General Fund, Schools, & Fleet)
- \$775,000 in additional local funding requested for Schools
- \$7.6 million in additional State funding for City Schools
- significantly higher energy costs in all areas of operations

The challenge of costs escalating at a pace higher than revenue growth made producing a balanced budget very difficult.

### Budget Analysis

The *Proposed FY 2007 Budget* was developed using a modified zero-based process. The zero-based process requires each department to prepare a budget request that reflects the actual costs of performing its responsibilities as if it was being done for the first time. Merely proposing incremental additions to a previous year's budget is not acceptable. In a zero-based approach, the fact that a dollar was spent the year before is not relevant to a request for that same dollar in the new fiscal year. Each dollar must be justified as supporting the functions and operations of the department.

For the previous four fiscal years the zero-based approach was supplemented by detailed budget analysis by volunteer City staff and citizens. That scrutiny resulted in a good understanding of each department's budget and the elimination of unjustified spending. Although volunteer analysts were not used for the preparation of the *Proposed FY 2007 Budget*, budget office staff and City administration met with each department for a line item review. During those meetings additional information was provided or requested for later review to further justify proposed spending.



### Balancing the General Fund Budget

The process of balancing the budget required tough decisions after a serious consideration of requirements versus priorities and other wants.

In balancing the *Proposed FY 2007 Budget* the following decisions were made:

#### Expenditure Adjustments

- The elimination of 13 existing authorized positions (\$684,000)
- No funding of requests for fifteen (15) new positions including five (5) new police officers, an Assistant City Attorney, six (6) positions in Social Services, and the conversion of Animal Warden, and Fire positions to full time (\$629,000)
- Anticipated Managed Vacancy savings (\$1 million)
- Reduction to the local funding of City Schools (\$1.5 million)
- Not funding new requests from local non-profit organizations (\$147,000)
- Reduction of fleet vehicle replacements (\$553,000)
- Not funding a request from the Electoral Board for new voting machines (\$178,000)
- The decision to fund the Neighborhood Alliance Network with one time funds rather than recurring revenues with a goal of seeking grant funding (\$182,000)
- A reduction in funding for overtime in the Police Department (\$232,000)
- A reduction in funding of the General Fund Reserve for Contingencies (\$400,000) with that amount to be made up from funds unspent in FY 2006
- Not funding numerous departmental requests for additional equipment, technology, furnishings, and operating supplies.
- A reduction in anticipated expenditures for prisoners in the Blue Ridge Regional Jail by assuming stable occupancy (\$365,000)

#### Revenue Adjustments

The following adjustments were made to preliminary revenue estimates:

- Revenue estimates were revised upwards in the areas of Real Property Tax, Meals Tax, and Sales Tax.
- Additional revenues of \$32,000 from a proposed increase of \$5.00 to Parking Fines (from \$10 and \$20 to \$15 and \$25, respectively).
- The proposed collection of a 1% tax on the rental of certain items (DVD's, videos, furniture and equipment) as authorized by State law but currently not collected (\$70,000)

The actions noted above, combined with various other minor adjustments in both expenditures and revenues and the use of fund balance for one time expenditures as allowed by the City's financial policies balanced the *Proposed FY 2007 Budget*.



### The Budget Document

The budget document provides a complete description of the resources received by the City from all sources and their uses. All of the various funds utilized by the City are shown along with their proposed revenues and expenditures and balances.

New to the budget document for FY 2007 is information on major tax revenue sources. For major revenue categories, those generating in excess of \$1 million annually, information is provided on the enabling legislation, rate history, the amount of revenue generated and the percent change from year to year. Graphs are included to illustrate revenue history. This new revenue information can be found in the summary pages behind the General Fund tab.

Major categories within the General Fund are grouped substantially in accordance with guidance provided by the State Auditor of Public Accounts for comparative cost reporting. The budget document also includes organization charts for each department/division that show which positions are supported by local revenues and which are supported by other means such as federal or state aid or grants. Finally, under each General Fund department is a comparison of the request for FY 2007 to the adopted FY 2006 Budget and a listing of major items requested by the department but not recommended for funding.

### Performance Measures

For the second year, the budget document includes performance measures for each department. The measures are meant to demonstrate the City's commitment to results oriented government that promotes the City's mission of providing services in the most efficient, effective and equitable manner possible and improving the quality of life in Lynchburg. Just as overall financial performance is measured against adopted policy goals, program performance can be measured against set objectives.

Performance measures for FY 2007 are slightly modified from the previous year as a result of feedback from City Council and the organization's learning how to better utilize this management tool. Looking forward, the City has joined *The Center for Performance Measurement* of the International City/County Management Association (ICMA) and is a member of a 28 member Virginia consortium of local governments utilizing performance measurement. In addition to providing the opportunity to learn best practices for the use of performance measurement, membership in the consortium will provide comparative data to help the City judge its efforts.

### **General Fund Revenues**

Total General Fund revenues for FY 2007 are projected to be \$139.8 million, representing an increase of \$5.6 million or 4.2% above the *Adopted FY 2006 Budget*. General Fund revenues consist of both Dedicated Revenues (\$25.6 million) and Non-dedicated revenues (\$114.2 million).

### Dedicated Revenues

Dedicated revenues are those revenues that are specifically designated by the Federal, State or City government to be used for specific programs and include federal and state categorical aid and grants,



interfund transfers, charges for services and reimbursement for indirect costs from enterprise funds. Dedicated revenues in the *Proposed FY 2007 Budget* total \$25.6 million, an increase of approximately \$598,000 over the current year. Projections may have to be adjusted after finalization of the state budget.

**Federal Categorical Aid** is primarily funding for social services programs and totals \$5.9 million.

**State Categorical Aid** provides funding for Constitutional Officers, juvenile corrections, highway maintenance, social services programs and supports the public library. Funding is expected to total \$14.8 million, an increase of approximately \$1.3 million, due to additional support for highway maintenance and social services.

**Interfund Transfers** of approximately \$ 281,000 are related to reimbursements for various costs to the General Fund. This amount is approximately \$337,000 less than in the FY 2006 Budget due to the loss of Federal Revenue Maximization Funds for Social Services Programs.

**Miscellaneous Revenue** totals approximately \$2.8 million and is comprised mostly of indirect cost allocations to the Solid Waste, Water, Sewer, Airport and Detention Home funds for services provided by General Fund departments. This is approximately \$294,000 less than the previous year due to a recalculation of the indirect cost allocations to the enterprise funds. Although this results in less revenue to the General Fund, the enterprise funds will experience reduced costs in this area.

### Non-Dedicated Revenues

Non-dedicated revenues, or those revenues that can be used at the City's discretion, are projected to increase approximately \$5.0 million from the *Adopted FY 2006 Budget*.

Slightly less than eighty-five percent (83.9%) of non-dedicated revenues and nearly seventy percent (68.5%) of total General Fund revenues are generated by six local taxes, the Real Property Tax (\$40.5 million), the Personal Property Tax (\$18.6 million, including the state reimbursement), the Local Sales Tax (\$13.3 million), the Meals Tax (\$9.2 million), Consumer Utility Taxes (\$7.3 million) and the Business License Tax (\$6.9 million). With the exception of the real property tax, these revenue sources are especially sensitive to economic conditions. Although not as much as last year, they are experiencing slight growth.

### General Property Taxes

**Real Property Tax** revenues are projected to total \$40.5 million, an increase of approximately \$1.2 million, or about two percent (2.0%) from the FY 2006 revised estimate. The increase is due to some growth through new construction and rehabilitation. Real Property Tax revenue projections are adjusted for an historically uncollectible percentage of two percent (2%), tax relief for the elderly (\$532,000) and rehabilitation tax credits (\$254,000). For budget discussions, each penny on the Real Property Tax rate will generate approximately \$365,000. This revenue source represents approximately one-third (35.5%) of General Fund non-dedicated revenues.



**Personal Property Tax** revenues are projected to increase approximately nine percent (8.8%) from the current year. The local share of the Personal Property Tax category totals \$12.8 million with the State reimbursement component totaling \$5.8 million. The combination of local and State shares represents about sixteen percent (16.1%) of General Fund non-dedicated revenues in the proposed budget.

**Public Service Corporations Tax** revenue is projected to decrease by about \$400,000 or sixteen percent (16%) from \$2.5 million to \$2.1 million. The value of public service corporation real property in the City is assessed by the State which has determined that the assessed value has actually fallen.

#### Other Local Taxes

**Local Sales Tax** revenue is the third largest portion of non-dedicated revenues to the City, representing eleven percent (11.6%) of those funds. Projections indicate an increase of approximately \$1 million from the *Adopted FY 2006 Budget*, to \$13.3 million.

**Consumer Utility Tax** revenues are projected to change little from FY 2006, remaining at approximately \$7.3 million.

**Meals Tax** revenues continue to grow. The revenue estimate of \$9.2 million represents over eight percent (8.1%) of General Fund non-dedicated revenues. Revenue growth of \$300,000, or 4.2%, is projected for FY 2007.

**Business License Tax** revenues of \$6.9 million reflect a slight increase of less than \$100,000 from the current year. This source makes up about six percent (6.0%) of General Fund non-dedicated revenues.

**Motor Vehicle License** revenues are projected to remain stable at approximately \$1.5 million.

**Amusement Tax** revenues are projected to decrease slightly from \$392,000 to approximately \$340,000.

Other revenues in this category make up approximately \$5.0 million of the FY 2007 revenue stream. This category includes **Right of Way Fees** (\$300,000), **Cable Franchise License Fees** (\$560,000), **Electricity and Gas Consumption Taxes** (\$350,000), **Bank Stock Taxes** (\$585,000), **Recordation Taxes** (\$600,000), **Tobacco Taxes** (\$1.1 million), and the **Transient Occupancy and Lodging Tax** (\$1.5 million; 36% of these funds, or \$528,000, will be provided to the Lynchburg Regional Chamber of Commerce for the Tourism Program).

**Permits, Fees, and Licenses** (\$910,000), **Fines and Forfeitures** (\$582,000) are projected to increase slightly in FY 2007, and **Revenue from the Use of Money and Property** (\$1.3 million) is projected to increase due to a more aggressive investment strategy and improving interest rates. An increase in parking fines of \$5.00 per ticket is proposed to generate an additional \$32,000 in annual revenue.

**Charges for Services** are projected to remain at about \$1.9 million.

**Non-Categorical State Aid** totals \$9.9 million and includes a number of sources. The largest is the state reimbursement for the Personal Property Tax Relief Act (\$5.8 million) which will be down



slightly from the current year due to a cap on the amount of local reimbursement statewide. Of significance is increased funding under the provisions of House Bill 599. The Governor's proposed State Budget includes an additional \$640,000 in HB599 funding, bringing Lynchburg's allocation to \$3.5 million.

**Miscellaneous** revenues are projected to be approximately \$327,000.

### **General Fund Expenditures**

Proposed General Fund expenditures of \$147.1 million represent an increase of \$10 million or 6.8% over the *Adopted FY 2006 Budget*. The difference between \$147.1 million in revenues compared to \$139.8 million in revenues is explained by the use of cash reserves, in an amount of \$7.3 million, for one time purposes as allowed by adopted financial policy. The General Fund finances all government activities with the exception of the Airport, Solid Waste Management, Water, and Sewer utility operations. All major funds contribute to the operations of the Fleet Internal Services Fund. A comparison of each of the General Fund operating departments as a percentage of total General Fund expenditures demonstrates the impact of these service areas on the entire proposed spending plan.



**Expenditures as a Percent of Total General Fund Expenditures****Proposed FY 2007**

	<u>General Fund Expenditures</u>	<u>Percent of General Fund</u>
General Government	\$11,561,190	7.9%
Judicial Administration	\$4,019,308	2.7%
Public Safety	\$28,462,435	19.4%
Public Works	\$14,743,532	10.0%
Health and Welfare	\$14,589,423	9.9%
Parks Recreation and Cultural	\$4,802,529	3.3%
Community Planning and Development	\$2,201,923	1.5%
Contributory Agencies	\$6,336,223	4.3%
Non-Departmental	\$4,705,473	3.2%
Schools	\$30,549,256	20.8%
Transfers	\$3,929,593	2.7%
Transfer to City Capital	\$7,436,128	5.1%
Reserves	\$800,000	0.5%
Debt Service	\$12,898,703	8.8%
<b>TOTAL GENERAL FUND</b>	<b>\$147,065,734</b>	<b>100.0%</b>

**General Government** includes the Council/Manager Offices, the City Attorney, the City Assessor, the Commissioner of the Revenue, Communications & Marketing, Financial Services, Human Resources, Information Technology, Internal Audit, the Electoral Board, the Registrar and the Treasurer. **Judicial Administration** includes the Circuit, District and Juvenile and Domestic Relations Courts, the Clerk of the Circuit Court, the Commonwealth's Attorney, the Magistrates Office, the Sheriff and the Court Services Unit. **Public Safety** includes the Police Department, the Fire and EMS Department, the Animal Warden, and Emergency Communications. **Public Works** includes Administration, Engineering, the Geographic Information System (GIS), Buildings and Grounds, Snow and Ice Removal and Streets. **Health and Welfare** includes Social Services and Juvenile Services. **Parks, Recreation and Cultural** includes Parks and Recreation, the Library, and the Museum system. **Community Planning and Development** includes Planning, Neighborhood Services, Inspections, and Economic Development.

**Contributory Agencies** are groups that provide services to the City outside of general government activities. Some activities, such as the regional jail, are mandated. The City has contractual relationships with other agencies. Funding of some organizations is discretionary. Some of the organizations historically funded in this area are non-profits that provide services through volunteers, private donations and grants along with a supplement from the City. The services that they provide are typically not provided by local government but may impact local government services indirectly.

**Non-departmental** includes those miscellaneous components of the City budget that generally do not fit nicely into an individual departmental budget but are widespread throughout, such as medical and dental costs and a general salary increase if programmed. **Transfers** include payments from the General Fund to other funds as a subsidy or payment for services. The most significant transfer is for City Schools.



### Local Contribution to City Schools

Local funding in an amount of \$36.6 million is proposed for school operations (\$30.55 million) and debt service (\$6.1 million). This represents a \$200,000, or 0.5%, decrease in local funding for school operations from the current year. The funding request from the School Board asked for an additional \$774,818 in local funding compared to FY 2006. At the same time nearly \$8 million in additional State funding was anticipated. The additional State funding is the result of benchmarking of the Standards of Quality, a reduction of the City's composite index from .3830 to .3500, and additional funding for pre-kindergarten programs. The latest estimates from the State Superintendent indicate that an additional \$1 million in State funding will be available. The additional resources from the State will allow City Schools to implement salary increases for teachers and staff and to add new positions in support of programs.

This budget proposes a local contribution for school operations of \$30.55 million, \$1.5 million less than requested and \$731,000, or 2.3%, less than provided in FY 2006. Local governments have long argued that the State has not carried its fair share of local public education costs. The additional State revenues being made available for FY 2007 address the imbalance. Accordingly, it seems appropriate that the City take advantage of the additional State funding by reducing its contribution in order to fund increasing costs and reasonable salary increases for City employees.

With a projected decline in enrollment of 89 students from FY 2006, local per student support for operations will decrease 1.3%, from \$3,631 to \$3,583. Total appropriations for Schools, including all activities and funding sources, will total \$97.1 million.

### Significant Expenditure Increases

Significant changes from the current year in the proposed General Fund budget include the following:

- Funding to cover the increase in VRS retirement (\$726,000)
- Funding to cover an anticipated fifteen percent (15%) increase in active and retired employee health and dental coverage (\$860,000)
- Funding for a 3% general salary increase (\$1.5 million)
- An increase in overall Debt Service (\$1.6 million)
- Funding for targeted salary adjustments and reclassifications for greater market equity (\$75,000)

In addition to the recurring expenditures notes above, one-time funds were used for the following purposes:

- To bring the General Fund Reserve for Contingencies to \$1.2 million as required by policy (\$400,000)
- To fund the second year of the Neighborhood Alliance Network (\$125,000)

### New Initiatives

Given the fiscal challenges facing the City, the *Proposed FY 2007 Budget* cannot support any new initiatives.



### Debt Service

The City finances a large component of the Capital Improvement Program (CIP) with general obligation bonds. Schools debt service is increasing from \$5.5 million to \$6.1 million, City debt service is increasing from \$6.0 million to \$6.8 million, and Fleet debt service is increasing from \$200,000 to \$400,000 for a total increase in debt service costs of \$1.6 million.

The FY 2007-2011 CIP anticipates the issuance during FY 2006 of approximately \$24 million in bonds for capital projects. Major debt-financed projects include a new Juvenile and Domestic Relations Court, renovations to Sandusky Middle School and the Carter Glass Building, various transportation projects and continued work downtown and on the riverfront.

City Council's Debt Management Policy requires annual debt service expenditures for tax-supported debt to not exceed 10% of total General Fund expenditures plus transfers to the School Operating Fund and Reserve Allocations. FY 2006 debt service as a percent of operating expenditures is projected at nearly nine percent (8.8%).

### Reserves

The *Proposed FY 2007 Budget* includes the following reserves:

Reserve for Snow, Streets and Bridges	\$250,000
General Fund Reserve for Contingencies	\$1.2 million
Reserve for Court Facilities	\$83,448
Reserve for Health Insurance	\$195,000
Capital Reserve for Athletic Fields	\$500,000
Capital Reserve for Streets	\$3.3 million

The Reserve for Snow, Streets and Bridges serves as a contingency should the costs of snow removal exceed budgeted resources. It is funded by the dedication of General Fund revenues. Unused funds are subsequently transferred to the Capital Fund for pay-as-you-go financing of street and bridge projects.

The General Fund Reserve for Contingencies funds expenditures during the fiscal year that were unanticipated during budget development. Any funds remaining in this reserve at the end of the fiscal year revert to the General Fund Balance. The Financial Management Policies establish a goal of \$1.2 million for this reserve. The *Proposed FY 2007 Budget* meets this goal through a combination of recurring revenues and unused funds from FY 2006 (\$800,000 and \$400,000 respectively).

The Reserve for Court Facilities is funded through the collection of Criminal Court Fines. The State gives localities authority to collect a small fee for each case to be dedicated to court improvements. It is anticipated that these funds will be used costs related to the Juvenile and Domestic Relations Court capital project.

A Reserve for Health Insurance was funded in FY 2003 and FY 2004 to be used in the event that health insurance claims exceeded budgeted funds. The amount listed above represents the funds remaining in that reserve.



The capital reserves for athletic fields and streets are funded from fund balance.

### Fund Balance

City Council's Financial Management Policy requires an Undesignated Fund Balance equal to 7% of General Fund revenues with a targeted goal equal to 10% of General Fund revenues. In the event that the Undesignated General Fund Balance is used to provide for temporary funding of unforeseen emergency needs, the policy requires that the City restore the fund balance to the minimum of 7% within two fiscal years. If the Undesignated General Fund Balance falls below the target of 10%, the policy requires that it shall be restored to the 10% target within five fiscal years. The proposed budget provides for a 10% fund balance, amounting to \$14 million. It recommends utilizing \$7.3 million in fund balance for pay-as-you-go capital outlay. Most of that amount, \$5.5 million, came from the windfall resulting in FY 2006 from the transition of Personal Property Tax billing to twice a year.

The *Proposed FY 2007 Budget* complies with the financial management policy of matching ongoing expenditures with annual revenues. Utilizing fund balance to cover recurring costs is inconsistent with the financial management policies and would require actions to either increase revenues or reduce recurring expenditures in subsequent years.

### Personnel

As with any service organization, the largest part of the City's operating budget, approximately 60%, is devoted to employee compensation through salaries, wages and benefits. City Council understands the value of competitive employee compensation in recruiting and retaining a qualified, competent and diverse workforce capable of maintaining excellent core services. In furtherance of that goal, in November 2003, City Council adopted a *Compensation Philosophy* that articulates the principles under which the City's compensation plan will be managed. The City continues efforts to promote workforce stability and has experienced acceptable voluntary turnover rates and positive recruiting experience for most vacant positions.

The foundation of the City's compensation plan rests on the goal of attracting and retaining employees that are qualified, competent and representative of the community through pay ranges with minimums and benefits levels that are competitive with the relevant labor market. Using the Compensation Philosophy principles that guide periodic review of the pay plan, the Human Resources Department most recently measured market competitiveness in January 2006. That review indicated that, on average, the current pay range minimums lag the market by approximately six percent (6%) and average actual pay is approximately ten percent (10%) below the market average actual pay. The proposed budget includes \$75,000 to fund pay range and salary adjustments for positions where the annual market survey and internal factors indicated an adjustment to pay range minimum was justified. Overall, the budget proposes an average increase in compensation of three percent (3%) effective July 1, 2006. The City will continue with its program of performance based pay implemented on January 1, 2006 and actual adjustments for individuals will range from zero to approximately four percent (0-4%).

The City continues to experience rising health coverage costs due to increasing membership, industry-wide increases in prescription drugs, medical and dental services and recent claims experience. Increasingly, high cost claims are driving the overall cost of medical coverage as new, life-saving, albeit very expensive, medications and treatments become available to covered employees. It is projected that a



fifteen percent (15%) increase in medical and dental coverage funding for active employees will be required at a cost of \$540,000. Funding for the increase is included in the *Proposed FY 2007 Budget* without plan changes or shifting costs to employees. The enterprise funds will also see proportional increases. In addition, costs for retiree medical and dental coverage are expected to rise approximately \$320,000. The City will continue to maintain a modest Health Insurance Reserve to buffer unexpected costs.

Fifteen (15) new full-time positions were requested by General Fund departments: five (5) new police officers, six (6) positions in Social Services, an additional Assistant City Attorney, and the conversion of two (2) Animal Warden positions and an administrative position in the Fire Department from part-time to full-time. The only new position that is being supported in the proposed budget is for a Museum Educator. The position would be paid for with a combination of existing wage money and donations from private sources.

The proposed budget includes the elimination of thirteen (13) authorized positions. Additional details on those positions will be provided during budget deliberations.

The General Fund workforce supported by the *Proposed FY 2007 Budget* would total 1106.29 Full Time Equivalent (FTE) employees, composed of 912.03 full-time classified, 40.38 part-time classified, 17 grant full-time, 74.38 wage and 62.50 state positions. The City's workforce in all funds totals 1390.53 FTE's. This includes 1142.85 full-time classified, 44.63 part-time classified, 55.68 grant full-time, 84.87 wage and 62.5 state positions.

## **Fleet Services Fund**

The Fleet Services Fund is an internal services fund that manages the City's fleet of over 700 vehicles and equipment. The Fleet Services Manager reports to a Board of Directors consisting of representatives from various departments that utilize fleet services. The total operating budget of \$5.4 million for Fleet Services increased approximately twenty percent (20.4%) from FY 2006, primarily as a result of major equipment purchases and projected increases in fuel.

Annually, Fleet Services, in consultation with each department, determines the most efficient fleet replacement program for the next year based on actual miles driven and maintenance costs. A General Fund transfer of approximately \$973,000 is provided for fleet replacement in FY 2007. This represents an increase of \$23,000 from the *Adopted FY 2006 Budget*. The planned purchase of fire equipment will result in an increase in debt service of \$261,000 from FY 2006. Due to fiscal constraints, an equipment depreciation component has not been factored into the annual charges to departments for fleet replacement.

## **Capital Fund**

The *Proposed FY 2007-2011 Capital Improvements Program* (CIP) includes \$75.6 million for City capital projects and \$34.9 million for school capital projects. Adoption of the CIP is anticipated coincident with adoption of the annual budget. Major bond financed projects proposed for funding in FY 2007 include Major Bridge Repairs, Downtown/Riverfront improvements, a new Juvenile and Domestic



Relations Court building, and Old Graves Mill Road improvements. Proposed capital project appropriations total approximately \$31.8 million in FY 2007 for both the City and Schools.

Ideally, a portion of the Capital Improvement Program should be funded each year on a “pay-as-you-go” basis. Beginning in FY 2001, a portion of the fund balance above the targeted ten percent (10%) of General Fund Revenues was allocated to pay-as-you-go capital construction for smaller projects and/or projects that have a life of less than 20 years. The *Proposed FY 2007 Budget* provides \$7.4 million for pay-as-you-go projects. Some of this funding will come from the \$5.5 million windfall the City will experience in FY 2006 due to establishing twice-a-year billing for the Personal Property Tax. As previously mentioned to funding some designated projects, funds will be set aside in five reserves for Athletic Fields (\$500,000); Criminal Justice Academy furnishings (\$60,000), Traffic Management (\$50,000), Snow, Streets and Bridges (\$250,000), and Street Overlay (\$3,280,959).

A list of proposed pay-as-you-go projects is provided on the following page.

**FY 2007 Proposed Pay-As-You-Go Capital Projects****Buildings**

Major Building Repairs	\$1,498,049
<b>Total Buildings</b>	<b>\$1,498,049</b>

**Transportation**

GLTC	\$ 705,650
Street Overlay (Engineering Services)	\$ 16,200
<b>Total Transportation</b>	<b>\$ 721,850</b>

**Economic Development**

Facilities Maintenance Building - CVCC	\$ 40,000
General Development Support	\$ 225,000
Street and Utility Extensions	\$ 200,000
<b>Total Economic Development</b>	<b>\$ 465,000</b>

**Parks and Recreation**

Parks Paving and Lighting	\$ 230,000
Playground Replacement/Improvements	\$ 80,270
<b>Total Parks and Recreation</b>	<b>\$ 310,270</b>

**Miscellaneous**

Mobile Radio Replacement	\$ 300,000
<b>Total Miscellaneous</b>	<b>\$ 300,000</b>

**Reserves**

Athletic Fields Reserve	\$ 500,000
Criminal Justice Academy Reserve	\$ 60,000
Snow, Street and Bridge Reserve	\$ 250,000
Streets Reserve	\$3,280,959
Traffic Management Reserve	\$ 50,000
<b>Total Reserves</b>	<b>\$4,140,959</b>

<b>TOTAL GENERAL FUND PAY-AS-YOU-GO</b>	<b>\$7,436,128</b>
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**Airport Fund**

The Lynchburg Regional Airport is budgeted as a separate fund to clearly delineate its financial operation and the support from the General Fund. Cost Center revenues and a General Fund subsidy of approximately \$500,000 cover total expenditures of \$2.4 million. FY 2007 operating expenditures are projected to differ insignificantly from the current year. Additional costs related to contractual services, City administrative support, liability insurance and airport security are largely offset by parking lot revenues, landing fees, rental car concessions, fuel flowage fees, and federal security reimbursements. As



a result of increased revenues from the revenue centers the City's subsidy to the airport is projected to decrease by \$31,686 from the current fiscal year.

## **Water Fund**

The City's water system can be characterized as having low rates and ample capacity, while being positioned for significant growth opportunities in its customer base. In addition to serving 21,750 City accounts, water is sold by contract to the counties of Amherst, Bedford and Campbell and to several large industrial customers. The Water Fund operates as an enterprise fund and requires no subsidy from the General Fund. In fact, it makes a contribution to the General Fund in the form of an indirect cost allocation.

The FY 2007 utility rate study proposes a 4% increase in the water rate.

Water Fund total revenues are projected to increase by approximately \$660,000, from \$9.9 million to \$10.54 million. Expenditures, including debt service, are projected to increase from \$10.0 million to \$10.7 million. (These numbers will be subject to amendment once the rate study and borrowing plans are finalized.) In addition to personnel costs, the Water Fund is impacted by increased energy costs and an increase of approximately 30% in the costs of chemicals, materials and supplies.

With the proposed rate increase, the unrestricted cash balance is projected to be forty-three percent (43%) of total fund expenditures for FY 2007 with a debt coverage ratio of 1.21, in compliance with City Council's policy to maintain a fund balance at forty percent (40%) of annual fund expenses and a debt coverage ratio of no less than 1.2.

## **Sewer Fund**

The City's sewer system serves Lynchburg and portions of the surrounding counties. Although operated by the City, the wastewater treatment plant is a regional asset with capital and operating costs shared proportionally by the localities. The City also has contracts with several large industrial users. Like the Water Fund, the Sewer Fund is operated as an enterprise fund and requires no subsidy from the General Fund. It also provides an indirect cost allocation to the General Fund.

The *Proposed FY 2007 Budget* projects revenues of \$16.1 million, compared to expenditures of \$16.2 million (subject to revision after completion of the rate study and financing plan), and includes a four percent (4%) rate increase as required by the Department of Environmental Quality (DEQ). The level of rate increase is intended to maintain the fund balance and debt coverage ratio at levels that ensure compliance with a Special Order between the City and the DEQ for the correction of Combined Sewer Overflows (CSO) and to provide for operating and debt service costs. As with the Water Fund, the Sewer Fund is experiencing increased costs for personnel, energy and chemicals. Sludge disposal is another increasing cost. The other significant increase is for debt service related to CSO and other infrastructure work.

The special order with DEQ establishes a compliance schedule and project priorities for implementation of the CSO control plan. Although the City has spent nearly \$100 million on the CSO





control program since 1993, the estimated cost to complete the remaining necessary work is over \$284 million. The compliance schedule does not contain fixed dates for implementing the CSO control plan, but rather provides for implementation based on three criteria that reflect the limits of the City's financial capability. These criteria are:

1. The City is required to maintain rates so that the annual sewer bill for the average residential customer, using 7 hundred cubic feet (hcf) a month, equals or exceeds 1.25% of median household income (MHI).
2. The City is required to maintain a sewer operating debt coverage ratio within a range of 1.15 to 1.5.
3. The City is required to have reserve funds equal to no more than 25% of the prior year's budgeted operating expenditures.

With the rate increase recommended by the City's utility rate consultant, the unrestricted cash balance is projected to be 22% of fund expenses for FY 2007, with a debt coverage ratio of 1.29, therefore meeting the criteria defined by DEQ. Based on 2000 Census data, adjusted to July 1, 2005, the annual sewer bill for the average residential customer is estimated to be 1.28% of median household income.

### **Solid Waste Management Fund**

The Solid Waste Management Fund is established as an enterprise fund. The fund assesses solid waste disposal costs through a tipping fee at the landfill, and a decal and tag system for residential collection. Collection costs are covered through a General Fund transfer. In addition, residents are charged a monthly fee of \$4.40, added to utility bills, to pay for certain "common good" services such as litter control, response to illegal dumping, recycling, and bulk and brush collection. The fund is in a strong financial condition as a result of actions taken by City Council in 2003.

FY 2007 revenues are projected to be \$7.6 million against expenses of \$6.07 million. Reductions in expenditures from the previous year were in debt service (\$200,000) and a reserve for landfill expansion (\$900,000).

In 1999, City Council adopted financial policies that established a debt coverage ratio of no less than 1.2 and fund balance targets of 40% of annual fund expenses for enterprise funds. The *Proposed FY 2007 Budget* will meet the debt coverage ratio target. It is projected that the debt coverage ratio will be 3.32. The fund balance is projected to be 136% of fund expenses after adjustment.

The Reserve for Landfill Construction will be maintained at \$2.2 million. The purpose of the reserve is to accumulate funds for the construction of the next landfill cell in 2008 and to avoid borrowing for this expense. The long term goal is for landfill operations to be debt free by the time the useful space in the current location is filled up. Achieving debt free operations will allow the City to more freely explore alternatives to constructing another landfill.

Additional reserves will be dedicated to possible expenses related to the initiative to regionalize the solid waste disposal operations of the Region 2000 localities and Nelson County. The previously established reserve for landfill expansion will be supplemented by other funds from the fund balance with an ultimate goal of establishing a reserve of \$3-4 million. Again, the goal is to avoid the creation of debt



when addressing any capital costs related to the regionalization of area landfills. The expected costs of this initiative will be better known as discussions with the Department of Environmental Quality clarify both requirements and opportunities.

## Outstanding Issues

There are several outstanding issues that may impact budget deliberations.

- Revenue projections in the *Proposed FY 2007 Budget* are based on an analysis of actual revenues and trends up to January 1, 2006. Staff will re-examine revenues after April 1, 2006 and suggest appropriate adjustments.
- Legislation adopted by the General Assembly could add additional costs or impact revenues coming to localities. Staff will analyze how the actions of the General Assembly impact the proposed budget as information becomes available.
- Rising interest rates prior to the anticipated Spring 2006 bond sale could increase Debt Service Costs.

## Outlook

The City of Lynchburg faces many of the same challenges and opportunities as older core cities in the Commonwealth and the nation. Both have budget implications. Central cities tend to have a higher concentration of citizens in need of services due to the concentration of poverty within the older housing areas of the city and more convenient access to services. This impacts schools, social services, and public safety budgets. The political separation of cities and counties in Virginia exacerbates the situation because individuals in the counties who find themselves in need of lower cost housing and community services can move into the city and have their needs addressed without their county of origin having any responsibility for the costs of meeting those needs. That situation, coupled with trends of the middle class moving out of central cities, means that fewer citizens with the ability to pay are being taxed to provide services.

On the other hand, like many older cities, a significant number of individuals have “rediscovered” the City and want to live closer in, in historic neighborhoods, in traditionally designed new developments, and downtown. Downtown revitalization continues to gain momentum and a number of new projects will come on line in the next year. Two of the most exciting are the Bluffwalk hotel, restaurant and conference center and City Market Lofts, forty-seven market rate loft apartments next to one of the oldest farmers’ markets in the nation. Other downtown projects are in planning or construction and the City will continue to support private investment through its commitment to further improvements to downtown infrastructure and on the riverfront. Residential growth in the historic districts, downtown, in the new Wyndhurst development, and in other areas on the edges of the City has actually reversed the population decline. The latest estimate is that the 2000 Census count of a little over 65,000 residents has grown to 68,000 in 2006. Property values are also rising with next year’s reassessment expected to show increases of ten to fifteen percent (10-15%).

There are still a number of areas in the City with the potential to grow and for private property to become more valuable. With local revenues so dependent on the Real Property Tax, that is good news.



Lynchburg is fortunate that it has remained the center of business, cultural and retail activity in the region, although some new development of those types is occurring in the surrounding counties. The City has only fifty square miles, however, and it is incumbent on us to make the most of it. Our goal should be to encourage sustainable development and redevelopment in the City that increase property values, maintain and improve the quality of life of all City residents, respect the City's history, and enhance its beauty. One initiative that should be complete by the time this budget is adopted is the restructuring of the Departments of Public Works and Community Planning and Development into a new Department of Community Development that will work closely with the Department of Economic Development to ensure that both public and private investment in the City promote the goal stated above. Working in closer alignment the City staff will focus on realizing the greatest possible potential in such important areas as downtown, the Fifth Street Corridor, Midtown, Tyreeanna/Pleasant Valley, and the Old Forest Road/Lakeside Drive area on the City's edge. Other City edge locations also have development potential.

Another challenge facing older core cities is the slow decay of essential infrastructure such as water and sewer systems, bridges, and buildings. Lynchburg has the added challenge of the requirement that it address its combined sewer overflow issue. A system of collecting stormwater and wastewater that was cutting edge when installed decades ago is now a liability requiring hundreds of millions of dollars of construction and resulting in some of the highest sewer rates in the State. Without a doubt, the maintenance and improvement of the City's water and sewer infrastructure, parts of which are over 100 years old, is potentially the most costly long term challenge facing Lynchburg. Addressing this challenge will require creative thinking, and creative financing, and the willingness to consider ideas, such as the regionalization of the water and sewer systems, that might have been resisted in another time. The region is already looking at developing a regional water supply plan and at the cost of delivering water to the various localities from the City system.

It makes economic sense to consider a regional approach to delivering important public services. The Region 2000 localities have a good history of regional cooperation and are already considering several initiatives that hold the promise of improved efficiencies and reduced costs. The most active is a proposal to consolidate solid waste disposal operations under a regional authority. Initial evaluation indicates that participating localities would benefit from significantly reduced disposal costs. Work is currently underway to address regulatory agency concerns and program actualization could be only a few years away. Another exciting initiative is the start of discussions to establish a regional airport authority with the goal of strengthening this important community economic development asset. Among the responsibilities of a new regional airport authority could be the management of a commerce park on property adjacent to the airport that is owned by Campbell County and the City of Lynchburg.

Another area of concern is the escalating cost of providing government services. Although critics suggest that spending should increase no more than the annual inflation index published by the Federal government, what they fail to recognize is that many costs, such as fuel, health care, and materials are rising at rates much higher than the consumer price index. As a result, every year there is the dilemma of overall costs rising at a rate higher than revenue growth. Because so many City services can only be delivered by individuals, the major component of the cost of those services is related to compensation and benefits. Continuing to fund increasingly costly benefits and trying to maintain competitive wages are the major cost drivers of this proposed budget.

The option of cutting costs by eliminating services has been discussed and rejected in previous years. As a result, there is an increasing focus on working to make sure that the work force is properly



sized and is working in the most efficient and effective way possible. This focus is manifested in two primary efforts. The first is the City's participation in a program of performance measurement and benchmarking with other communities. The second effort is to reduce the size of the City staff. The elimination of thirteen authorized positions in the proposed budget is a part of that effort. In addition, throughout the year every vacancy is analyzed to determine if the position can be cut and the responsibilities met in another manner. As a matter of principle those positions that are directly delivering the services are the most protected. The result has been a reduction of positions in the areas of management and administrative and financial support. This effort will continue along with an examination of City processes and the potential for greater use of technology to streamline activities.

## **Conclusion**

The *Proposed FY 2007 Budget* is offered for City Council consideration, deliberation, amendment and adoption. Over the next several weeks, Council will have the opportunity to hear from and question the representatives of the various departments and agencies seeking funding in FY 2007. Work sessions will be held on Tuesday afternoons throughout the months of March and April. A public hearing on the proposed budget is scheduled for April 4, 2006, at 7:00 p.m., in Council Chambers. During Council's deliberations, staff is prepared to provide assistance and additional information as Council works towards budget adoption.

Copies of the *Proposed FY 2007 Budget* are available for public review at the main public library and the downtown branch as well as on the City's website at [www.lynchburgva.gov](http://www.lynchburgva.gov).

## **Acknowledgements**

A number of City staff assisted in the development and production of the *Proposed FY 2007 Budget* and I would like to acknowledge their hard work. Once again Deputy City Manager Bonnie Svrcek provided outstanding leadership for the overall budget process. Interim Director of Financial Services Donna Witt, Michelle White and Cindy Speck in the Budget Office, Director of Human Resources Margaret Schmitt, and Human Resources Specialist Beth McDaniel provided valuable analysis, review, and logistical support in the development and production of the budget document. Financial Services staff Barbara Hudson, Leti Vance, Amanda Smith, Irina Fuller, Kathy Collins, Fred McWane, and Deborah Powell also provided assistance.

Finally, I want to recognize the directors and staff of the various City departments who are committed to our mission to deliver services to Lynchburg's residents, workers and visitors in an efficient, effective and equitable manner and to build a stronger community. In the end, it is the City employees who put the annual budget into action. Every day, they respond directly or indirectly to the citizens of this community. They are the City government's greatest assets and they do an outstanding job.